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STATEMENT OF  
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BEFORE THE  
SUBCOMMITTEE ON CONSUMER PROTECTION AND FINANCE (2302)  
HOUSE COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE  
ON  
[FEDERAL TRADE COMMISSION'S (59)  
CONSUMER REDRESS ACTIVITIES]



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Testimony

Mr. Chairman and Members of the Subcommittee:

We are pleased to appear here today to discuss our report on the Federal Trade Commission's limited success in helping consumers to obtain redress for economic injury resulting from unfair or deceptive business practices. We issued that report to the Congress on October 17, 1978.

Although a majority of businesses in this country operate reputably, unfair and deceptive practices by some companies pose serious problems for consumers and Federal, State, and local law enforcement officials.

When taken advantage of by unfair practices, consumers should seek redress. Consumer redress is satisfaction or payment to consumers by businesses for economic injury resulting from unfair or deceptive business practices. Redress can be in different forms including restitution of all or part of the consumers' financial loss, rescission of the contract between the business and the consumer, or a requirement that the business provide the promised goods or services.

Because of its broad powers and responsibilities and national jurisdiction, the Federal Trade Commission is in a unique position to reduce unfair and deceptive acts and practices in the marketplace. It is also able to seek, through the courts, redress for consumer losses resulting

from acts and practices which a reasonable person would have known were dishonest or fraudulent.

Our report discussed the Commission's activities concerning three programs--vocational schools, land sales, and business opportunities--because these programs were among the most active in terms of consumer redress.

Many consumers are easy targets for vocational training abuses. They may be persuaded by misleading advertisements and salespeople promising the training and placement help needed to get jobs such as a medical assistant, an insurance adjuster, or a truck driver. The career hopes of many students dim after completing the courses when they are unable to get jobs. This happens in some cases where employers consider the vocational training as unacceptable or where the school's training or placement services may be inadequate. The student's investment of as much as \$1,000 or more and many hours of time and effort in the training program proves virtually worthless.

People can also lose money on new business ventures. Take, as an example, a couple that invests their hard-earned life savings in a business opportunity that promises a chance to work at home and earn yearly gross profits from \$39,000

to \$67,000. Such advertising is enticing. Unfortunately, many people, like this couple, never see profits and instead lose much or all of their original investments.

Still other consumers are victims of land sales schemes. A seller may carefully lead a consumer into buying underdeveloped land by misrepresenting facts. For example, the seller may say that recreational facilities will soon be available, that development potential of the area is good, or that the land is an excellent investment. If these representations prove false, the consumer seeking financial gain or a home with facilities and amenities of a successful development may be left instead with largely underdeveloped land with a market value below cost.

#### LIMITED SUCCESS IN GETTING CONSUMER REDRESS

In many Commission cases, consumers have not received any redress. Even when the Commission is able to obtain redress it is often small or available only to a limited number of injured consumers.

The Commission did not obtain any consumer redress in 12 of 24 cases involving vocational schools, land sales, and business opportunities that were resolved between January 1975 and August 1978. In one case where no redress was obtained, the Commission issued a consent order on October 19, 1977,

against a vocational school for misrepresenting current and future job prospects for students completing its gas turbine mechanics course. Commission staff estimated that from mid-1972 to mid-1975, about 2,500 students enrolled in the course but received little or no benefit from it. The course tuition in 1975 was about \$1,100; the Commission estimated the total consumer loss at \$2 million.

In another case, the Commission's investigation of an idea-promotion company showed that it misrepresented, among other things, its engineering and marketing ability to develop and promote clients' ideas and to obtain financial gain for its clients. Consumers spent from \$750 to \$1,200 each to have their ideas and inventions promoted. Few realized gains. Commission staff estimated the total consumer loss at about \$750,000.

The Commission did obtain some redress in the other 12 cases but the redress obtained was generally much less than the consumers' losses and was provided to only some eligible consumers. For example, in January 1975 the Commission settled its case against a vocational school offering courses such as computer keypunching, computer programing, secretarial training, and medical and paramedical personnel training. Commission staff estimated that students paid about \$12 million in tuition for courses

which were virtually worthless for future employment. The negotiated settlement required the school to refund up to \$1.25 million to certain students. The school had difficulty locating students eligible for the refund and ended up paying back only about \$675,000.

On July 13, 1976, the Commission settled its case against another vocational school. The Commission charged the school with using unfair and deceptive practices in promoting and selling trailer truck driver courses. Commission staff estimated that 1,950 students each paid \$795 in tuition, about \$1.5 million in total, from 1971 to 1973. The negotiated settlement required the school to pay a total of only \$25,000 to students enrolled in the courses during calendar year 1973. In the end, 292 students each received about \$86.

Commission staff negotiated a settlement only for students enrolled during calendar year 1973 mainly because (1) an extensive survey of students enrolled during the other years would have been needed and (2) with the school having limited assets for restitution, expansion of the refund period might have doubled or tripled the number of eligible students, significantly reducing the amount of restitution each would receive.

These are two cases in which the Commission obtained some restitution for consumers. The amount of restitution obtained in most of the other cases was also substantially less than the consumer losses.

Redress has not always been restricted to restitution. In two land sales cases the Commission obtained consumer redress other than restitution, such as land improvements. While the cost of the redress package to the business can be estimated, the total value provided to consumers is difficult to measure.

For example, on September 27, 1977, the Commission settled its case against a land sales company charged with deceiving consumers in land sales transaction. Over 10,500 lots in Arizona were sold at an average unit price of over \$4,000. Commission staff valued these lots at about half that amount. While no detailed analysis was made, the estimated consumer loss was between \$17 and \$21.5 million. The major part of the Commission's settlement did not provide any restitution to individual consumers. It did, however, require the company to spend about \$4 million on improvements and recreational facilities, including those originally promised to consumers along with some additional improvements. The real value of the redress package to consumers however, is unclear.

REASONS FOR  
LIMITED SUCCESS

The Commission's ability to obtain consumer redress has been limited by

- its impractical authority because of lengthy and time-consuming procedures;
- the weak financial condition of many businesses it investigates; and
- its internal management problems.

The Commission's authority  
is impractical

In January 1975 the Congress added section 19 to the Federal Trade Commission Act (FTC Act) to enable the Commission to seek redress for consumers in Federal district courts or any State court with jurisdiction over such matters. Section 19(a)(1) authorizes the Commission to go directly to court to seek redress for consumers harmed by violations of the Commission's rules. Section 19(a)(2) authorizes the Commission to seek redress for unfair and deceptive practices which result in a final Commission order but requires the Commission to go through both administrative and judicial processes.

Section 19(a)(2) also provides that the courts are to order consumer redress only if the Commission proves that the act or practice resulting in a final order is



one which a reasonable person would have known was dishonest or fraudulent. The legislative history on this provision indicates Congressional concern about protecting a business from the unforeseen liability of redressing consumers in those situations where the business would have no reason to suspect it was behaving unlawfully.

The administrative and judicial processes add considerably to the time it takes the Commission to obtain redress under section 19(a)(2). The Commission must first issue a final order which can take several years. Once the order becomes final, the Commission must within 1 year initiate a second process which involves a State or Federal court proceeding which can also take several years.

In a majority of the 43 redress cases we reviewed, four years or more elapsed from the start of an investigation until the Commission issued a final order. In fact, of the 17 cases still in process when we finished our audit work in August 1978, 13 had been active for at least four years.

Long time frames can have a negative impact on consumer redress. First, as time passes, particularly if the case involves litigation, there is a greater chance that company assets will be unavailable for redress. Second, it becomes increasingly difficult as the years go by to locate consumers eligible for refunds. Therefore, fewer consumers

may receive benefits. Third, years of inflation reduce the value of any refunds obtained. Finally, the Commission's bargaining position in negotiating settlements is weakened where a long processing time is viewed as inevitable.

It is significant to note that in the four years since the Congress added section 19 to the FTC Act, only two redress cases have reached the courts under section 19(a)(2).

To give the Commission clearer and more practical authority to obtain redress for economically injured consumers, we recommended that the Congress amend section 19(a)(2) of the FTC Act to authorize the Commission, after a hearing, to order redress if it determines that a reasonable person would have known that the violations were dishonest or fraudulent. Under this concept businesses would be protected from unforeseen liability as the Congress originally intended in enacting section 19 and the need for a separate judicial process would be eliminated.

Weak financial conditions  
limit a business' ability to  
provide consumer redress

In many of the potential redress cases we reviewed, the poor financial condition of the business was one of the major reasons that the Commission accepted a settlement that did not provide for full redress to injured consumers.

In 3 of the 24 completed cases we reviewed, the business had closed. In 14 others, Commission staff cited the businesses' weak financial condition in recommending that the Commission accept settlements which required the companies not provide redress for consumers injured by past actions.

The Commission Chairman has stated that violators have often dissipated their assests and left only a shell of a closely held corporation before the Commission could complete its case. For example, the first section 19 redress case came under Commission investigation in 1968. From mid-1967 through mid-1972 when the Commission issued its complaint against the company, it had grossed about \$44 million from its challenged practices. Between 1972 and 1973 the company's total assets dropped from \$22.5 million to \$11.7 million. The Commission issued a final order to the company in 1976 and began the redress action in February 1977. In November 1978 the Commission determined that only a limited amount of assets could be recovered for consumers and, that even if the Commission were successful, the amount it would recover would not redress, to any substantial degree, the injury to consumers. Therefore, the Commission withdrew its case and the suit was dismissed.

Preservation of company assets in consumer redress cases may be necessary to better assure that the assets

will be available for consumer redress. Although the Commission may ask a district court to preserve a company's assets once the section 19 proceeding is underway, its authority to preserve a company's assets pending completion of administrative proceedings is not clear. Section 13(b) of the FTC Act authorizes the Commission to seek a court injunction against a company about to violate any law the Commission enforces. However, the Commission's injunctive authority does not explicitly provide for the use of injunctions to preserve a company's assets. When the Commission has reason to believe that a company may be dissipating its assets to avoid redressing consumers, we believe that the Commission should be able to seek an injunction to preserve those assets until it can complete its administrative proceedings. Accordingly, we recommended that the Congress amend section 13(b) of the FTC Act to authorize the Commission to seek an injunction to prevent businesses from dissipating their assets to avoid redressing consumers.

Management problems reduce  
Commission effectiveness  
in obtaining redress

If consumers are to receive adequate redress, the Commission should begin cases as soon as possible and handle them expeditiously. Case delays weaken the consumers'

position by lessening the potential for obtaining redress and reducing the value of any redress received. The Commission has experienced delays in some redress cases because of lengthy negotiation periods, lack of adequate consumer injury analysis, and problems with policy communication. Commission officials recognized these management problems and have revised operating policies and procedures.

Lengthy negotiations between the Commission and a business to reach a settlement agreement often caused the Commission's investigative activities to be suspended and evidence of deceptive practices to become stale. Dated evidence weakens the Commission's ability to litigate a case and seek consumer redress under section 19(a)(2). To eliminate the problem, in December 1977 the Commission's Bureau of Consumer Protection directed its staff to limit suspension of investigative activity during negotiations to 20 staff hours or 20 days, whichever comes first.

Consumer injury analyses are important because on every case questions can arise on a variety of issues such as (1) the choice of remedies; (2) whether to accept a consent agreement or issue a complaint; and (3) whether to require restitution for past transactions, protect consumers in future transactions, or both. Analysis of these issues

requires a thorough understanding of the amount and nature of the consumer injury. The Commission has not always adequately analyzed these issues before attempting to negotiate a redress settlement. Such an analysis can be difficult, costly, and imprecise, but if it is not done adequately it can slow down the case or lead to an inappropriate decision.

In recent cases lack of adequate consumer injury analysis created problems in case handling. After review of these cases, Commission officials informed the staff about the need to obtain sufficient information to evaluate the propriety of seeking consumer redress. Also, in January 1978 the process for evaluating staff requests for Commission action was restructured so that attention is focused on the analysis of consumer injury at the outset of formal investigations.

When communications problems occur, delays in processing redress cases are inevitable. The Commission has had much difficulty communicating policies and procedures, including those pertaining to potential redress cases, to its staff. Studies by outside consultants and internal committees found this communications problem to be serious and frustrating to staff.

The Commission has implemented periodic review sessions of pending matters so that early communication of policies can be assured. In addition, the Commission told us that its Bureau of Consumer Protection and Office of General Counsel have established procedures to assure development of consistent policies and eliminate some review delays.

Several of the Commission's changes or proposals should expedite case processing and put consumers in a better position to receive redress. The Commission must emphasize and assure, however, that the management changes provide accelerated case processing, better communications among the staff and the Commission, and, ultimately, more equitable redress for injured consumers.

Therefore, we recommended that the Commission ensure that redress cases are handled as expeditiously as possible by monitoring the implementation of its management changes designed to reduce delay and improve communications.

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Mr. Chairman, that concludes our prepared statement. We will be pleased to answer any questions that you or other members of the Subcommittee may have.